SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 158

[illegible] T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES J. CANFIELD

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 34131

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances:

For Taxpayer: Andrew L. Campbell, C.P.A., Edwin H. Cassels, Esq.

For Comm'r.: Harold Allen, Esq., H. D. Thomas, Esq., Willis R. Dansford, Esq.

Docket entries

1928

Jan. 20—Petition received and filed. Taxpayer notified. (Fee paid.)

Jan. 21—Copy of petition served on general counsel.

Mar. 17—Answer filed by general counsel.

Mar. 20—Copy of answer served on taxpayer. General calendar.

1930

Feb. 19—Hearing set April 3, 1930.

Mar. 21—Motion to place on the reserve calendar, filed by general counsel. March 24, 1930, granted.

Aug. 19—Hearing set October 28, 1930.

Oct. 13—Motion to consolidate with docket 38095 and to postpone hearing to October 30, 1930, or thereafter, filed by taxpayer.

Oct. 15—Order of continuance to Oct. 30, 1930, for hearing on merits, entered. See 38095.

Oct. 30—Hearing had before Mr. Seawell, div. 4. Called on merits. Stipulation of facts filed. Briefs due in 60 days.

Nov. 12—Transcript of hearing Oct. 30, 1930, filed.

Dec. 27—Brief filed by taxpayer.

Dec. 29—Brief filed by general counsel.

1931

Jun. 12—Findings of fact and opinion rendered, Mr. Seawell, div. 4. Judgment will be entered under rule 50.

Jun. 29—Order that pursuant to section 601 (b) of Revenue
2 Act of 1928, the decision promulgated June 12, 1931, be reviewed, entered.

Aug. 6—Stipulation to file supplemental brief, filed.

Aug. 7—Order granting 30 days for petitioner and Commissioner to file supplemental briefs, entered.

Aug. 8—Supplemental memo. brief filed by taxpayer.

Sept. 3—Supplemental memo. brief filed by general counsel.

Oct. 27—Findings of fact and opinion rendered, Mr. Seawell, div. 4. Judgment will be entered under rule 50.

Nov. 23—Notice of settlement filed by general counsel.

Dec. 1—Hearing set Dec. 16, 1931, on settlement.

Dec. 16—Consent to settlement filed by taxpayer.

Dec. 16—Hearing had before Mr. Smith, div. 5, on settlement under rule 50. Referred to Mr. Seawell.

Dec. 21—Decision entered, Mr. Seawell, div. 4.

1932
Feb. 1—Petition for review to U. S. Circuit Court of Appeals (7) with assignments of error, filed by taxpayer.
Feb. 1—Praecipe filed.
Feb. 15—Proof of service of petition filed.
Mar. 10—Proof of service of praecipe filed.

Before United States Board of Tax Appeals

Petition

Filed Jan. 20, 1928

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:B-1:RRP-60D), dated November 25, 1927, and as a basis of his petition alleges as follows:

1. Petitioner is an individual, residing at 199 Lake Shore Drive, Chicago, Illinois, and having his principal office at 38 South Dearborn Street, Chicago, Illinois.

3 2. On or about November 25, 1927, the Commissioner of Internal Revenue mailed at Washington, D.C., to the petitioner at the above address a letter and notice of deficiency, claiming a deficiency in tax in the amount of $9,243.66 for the taxable year 1923, a copy of which notice of deficiency is hereto appended and marked "Exhibit A." An earlier letter is also attached marked "Exhibit C."

3. The taxes in controversy are income taxes for the calendar year 1923 in the amount of $9,243.66.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(I) The Commissioner of Internal Revenue erred in holding that the dividends received by this petitioner from West Side Lumber Company on, to wit, April 14, 1923, were 28.217% taxable (exhibit A), whereas such dividends were only 15.23% taxable.

(II) The Commissioner erred in computing the statutory taxable income of the petitioner by including therein the aforementioned dividends in the amount of 28.21% of $204,000 or $57,562.68 (exhibit A), whereas such dividends should have been included only in the amount of 15.23% of $204,000 or $31,069.20.

(III) The Commissioner erred in determining and assessing income taxes upon the statutory taxable income of the petitioner computed by including therein at least $26,493.48 out of a distribution made by West Side Lumber Company on April 14, 1923, out of surplus of such company accumulated prior to March 1, 1913 (exhibit A).

(IV) The Commissioner erred in holding that the net losses of $193,139.67 and $211,707.32 sustained by West Side Lumber Company in its fiscal years March 1, 1914—February 28, 1915, and March 1, 1915—February 29, 1916, are not to be considered in determining

the amount of earnings "accumulated" during the period March 1, 1913—April 14, 1923, and distributed on April 14, 1923, by West Side Lumber Company to its stockholders within the meaning of section 201 of the Revenue Act of 1921, whereas such losses should be deducted from the total of the earnings of the several fiscal years of the period March 1, 1913—April 14, 1923, in determining the amount of earnings "accumulated" during such period (Exhibit B).

4 (V) The Commissioner erred in holding that a certain sum, i.e., an amount equal to the losses of $193,139.67 and $211,707.32, sustained in the fiscal years ending February 28, 1915, and February 29, 1916, to wit: $404,846.99, was on April 14, 1923, paid by West Side Lumber Company out of its earnings accumulated subsequent to March 1, 1913, whereas in fact such sum was distributed out of capital and surplus accumulated prior to March 1, 1913 (exhibit B).

(VI) The Commissioner erred in holding that when West Side Lumber Company declared and paid to its stockholders on April 14, 1923, a dividend of $340.00 per share it distributed as a part thereof the entire net earnings of its fiscal year of March 1, 1923, February 29, 1924, to wit, $311,209.54 (exhibit B), whereas he should have held that he then distributed only 44/366ths of such sum, or $37,413.17.

(VII) The Commissioner erred in holding that a certain sum, i.e., 322/366ths of $311,209.54, to wit, $273,796.37, paid by West Side Lumber Company to its stockholders on April 14, 1923, was not paid out of the surplus accumulated by it prior to March 1, 1913.

(VIII) The Commissioner erred in determining that the income tax liability of the petitioner for the calendar year 1923 disclosed a deficiency in the amount of $9,243.66 (exhibit A).

(IX) The Commissioner erred in determining that the income tax liability of the petitioner for the calendar year 1923 disclosed a deficiency in any amount whatsoever, and in not finding that there had been an overassessment of income taxes against the petitioner for such year.

5. The facts upon which the petitioner relies as the basis of this proceedings are as follows:

(a) The taxpayer on March 14, 1924, filed his income-tax return for the calendar year 1923 reporting a net taxable income of $140,656.86. Included in such sum of $140,656.86, was an item of $33,360.00 returned as taxable income from a certain dividend received by him on April 14, 1923, with respect to 600 shares of common stock of that date owned by the taxpayer in the West Side Lumber Company. Upon this total of $140,656.68 of taxable net income, the income tax, normal and surtax, was computed at $37,222.57 and this sum was duly paid in four quarterly installments in the year 1924.

(b) West Side Lumber Company is a California corporation. Its capitalization on April 14, 1923, consisted of 15,000 shares of common stock of the par value of $100 per share. It has

5 continuously owned since March 1, 1913, all of the capital stock of Tuolumne Lumber Company. In 1906 the taxpayer acquired the above-mentioned 600 shares of the common stock of West Side Lumber Company and continuously thereafter owned the same through the taxable year 1923. On March 1, 1913, West Side Lumber Company had a surplus of $4,332,684.78, so that each share of its common stock had a book value of $388.85 on that date. The fiscal year of the company was and is the first day of March in each year to and including the last day of February in each year.

(c) The consolidated earnings of West Side Lumber Company and its subsidiary and the dividends paid by West Side Lumber Company after March 1, 1913, were as follows:

	Earnings	Dividends
Year ending February 28, 1914	$4,594.62	
" " " 28, 1915	−193,139.67	
" " " 29, 1916	−211,707.32	
" " " 28, 1917	60,495.56	
" " " 28, 1918	57,901.55	$90,000.00
" " " 28, 1919	208,737.34	
" " " 29, 1920	543,490.33	75,000.00
" " " 28, 1921	640,837.43	375,000.00
" " " 28, 1922	182,954.63	300,000.00
" " " 28, 1923	718,858.29	450,000.00
March 1 to April 14, 1923 (incl.); 44/366ths of $311,209.54	37,413.17	
	2,050,435.93	1,290,000.00

The difference between earnings and dividends paid for the period March 1, 1913–April 14, 1923, was $760,435.93, to which should be added sundry adjustments amounting to $16,323.04 (chiefly earnings of Tuolumne Lumber Company prior to March 1, 1917, which the Commissioner has omitted from his statement, exhibit B—less sundry donations, coupon tax, etc.), so that the consolidated surplus on April 14, 1923, was $5,109,443.75, or an increase of $776,758.97 over that of March 1, 1913. The book value of the common stock on April 14, 1923, was $440.63 per share. The net earnings of the company and its subsidiary for the period March 1, 1923–February 29, 1924, were $311,209.54 and the net earnings of the company and its subsidiary for the period April 15, 1923–February 29, 1924, were 322/366ths of $311,209.54, i.e., $273,796,37.

Attached hereto and made a part hereof as exhibit B is a letter dated August 25, 1927, and signed by the Commissioner. All the figures in the tabulation foregoing are set forth in such letter of the Commissioner as the correct earnings and losses of said

6 several years, with the exception of the figures of $208,737.34 and $37,413.17 for which the Commissioner substituted the figures of $289,937.34 and $311,209.54. The figures of $289,937.34 has been later corrected by the Commissioner (exhibit A) to $208,737.34 in computing the present alleged overassessment of $9,243.66. The figure of $311,209.54 used by the Commissioner represents the entire net earnings of the period March 1, 1923–February 29, 1924, while the figure of $37,413.17 is 44/366ths of $311,209.54

(i.e., the prorated earnings of the period March 1, 1923–April 14, 1923). The taxpayer accepts as correct the several figures used by the Commissioner as to the earnings of West Side Lumber Company in the several years March 1, 1913–February 29, 1924, except that of $289,937.34, but asserts that it is not proper to use the sum of $311,209.54 in computing the distribution from accumulated earnings made April 14, 1923, but that 44/366ths of that figure should be used.

(4) The surplus of March 1, 1913, was not in such form that it could be used for working capital, and it was necessary in 1915 and 1916 to borrow to pay current indebtedness resulting from the losses in those years. On September 15, 1915, the company issued its $700,000 first mortgage 6% Gold Bonds maturing, $175,000 each, March 15, 1918, September 15, 1920, March 15, 1923, and September 15, 1925. It paid and retired all these bonds out of its earnings of the period March 1, 1916, to March 1, 1923, as follows: March 15, 1918, $175,000; September 15, 1920, $175,000; February 28, 1921, $116,000; February 28, 1922, $57,000; February 28, 1923, $60,000; March 15, 1923, $117,000.

(e) On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000 upon its 15,000 shares of common stock, or a sum of $340 per share. The amount received by the taxpayer with respect to his above 600 shares from this distribution was $204,000 of which $31,069.20 was from earnings of the company for the period March 1, 1913–April 14, 1923, and $172,930.80 from its capital and surplus of March 1, 1913. However, he reported in his return of March 14, 1924, as taxable income from this source the sum of $33,360 instead of such sum of $31,069.20. The taxpayer now contends that instead of reporting too little taxable income from this source, he reported all his taxable income therefrom and he reported $2,230.80 too much.

(f) The Commissioner of Internal Revenue in arriving at the conclusion that the said dividend of $204,000 received by the taxpayer April 14, 1923, was 28.217% taxable considered:

7 (1) That the total of the earnings set forth in subparagraph (c), supra, in the several years of the period March 1, 1913–April 14, 1923, constituted the accumulated earnings of the company since March 1, 1913, without deduction for the losses of $193,139.67 and $211,707.32, respectively, for the year ending February 28, 1915, and February 29, 1916, and hence that these sums, or a total of $404,846.99, should be added to the above-mentioned sum of $776,758.97 (the difference between net earnings and dividends paid for the period March 1, 1913–April 14, 1923) in determining the "accumulated earnings" for the period March 1, 1913–April 14, 1923, and that the amount deemed distributed from the surplus of the company of March 1, 1913, should be diminished correspondingly by the same sum of $404,846.99, and

(2) That the earnings of West Side Lumber Company of $273,796.37 in the period April 15, 1923–February 28, 1924, were

distributed on April 14, 1923, and hence that the amount of the surplus of March 1, 1913, that was distributed on April 14, 1923, should correspondingly be reduced by the same amount below the figures arrived at by West Side Lumber Company;

The Commissioner, therefore, computed that, taking into consideration the above items of $404,846.99 and $273,796.37 and without considering the adjustment of $16,323.04, the amount of the March 1, 1913, surplus that was distributed April 14, 1923, was $1,439,079.29 and the amount of the earnings accumulated after March 1, 1913, distributed April 14, 1923, was $3,660,920.71 instead of the respective sums of $776,758.97 and $4,323,241.03 from said two sources claimed herein.

The Commissioner in consequence ruled that the income derived by the taxpayer from said 600 shares of stock on April 14, 1923, was 28.217% taxable and that the taxpayer instead of returning $33,360 as taxable income from this source (or $31,069.20 as now contended by the taxpayer) should have returned the sum of $57,562.68. The additional assessment of $9,248.66 is computed on the basis of the inclusion in the taxpayer's return as taxable income of such sum of $57,562.68 in lieu of $33,360 or $31,069.20.

The taxpayer contends (1) that the above losses of $193,139.67 and $211,707.32 should be deducted from the net earnings of the several fiscal years of the period March 1, 1913–April 14, 1923, in determining the amount of earnings accumulated after March
8 1, 1913, (2) that the earnings of $273,796.37 of the period April 15, 1923–February 29, 1924, were not distributed April 14, 1923, and (3) that sundry adjustments aggregating $16,323.04 should be included in earnings subsequent to March 1, 1913; hence that the total of earnings accumulated since March 1, 1913, and distributed April 14, 1923, was $776,758.97 and that said dividend was only 15.23% taxable, and that in consequence the taxpayer's taxable income from this source in 1923 was 15.23% of $204,000 or $31,069.20.

Wherefore, the petitioner prays that this Board may hear the claims of the petitioner; that it may redetermine the alleged deficiency in such notice of deficiency, that it may direct the Commissioner of Internal Revenue to recompute the income taxes of the taxpayer for the year 1923 in conformity with the claims and matters hereinbefore set out, and that it may find that there is no deficiency in the return of the taxpayer made March 14, 1923, or in the taxes paid by him based on said return, but that he has in fact paid for the year 1923 a greater tax than was lawfully due from him.

CHARLES J. CANFIELD,
CHARLES J. CANFIELD,
38 South Dearborn Street, Chicago, Illinois.
ANDREW L. CAMPBELL,
EDWIN H. CASSELS,
Attorneys for taxpayer.

[Duly sworn to by Charles J. Canfield, jurat omitted in printing.]

9 *Exhibit "A" to petition*

TREASURY DEPARTMENT,
Washington, Nov. 25, 1927.

(Seal) Office of Commissioner of Internal Revenue.

IT:FAR:B-1
RRP-60D

MR. CHARLES J. CANFIELD,
199 Lake Shore Drive, Chicago, Illinois.

SIR: The determination of your tax liability for the years 1923 and 1924 discloses a deficiency of $9,243.66 for the year 1923, as shown by the attached statement.

In accordance with the provisions of section 274 of the Revenue Act of 1926 you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D.C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision or such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:FAR:B-1-RRP-60D. In the
10 event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.
By C. B. ALLEN,
Deputy Commissioner.

Inclosures:
Statement
Form A
Form 882
Form 7861—Revised Mar. 1926.

Statement

IT:FAR:B-1
RRP-60D

In re: Mr. Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois

Year	Deficiency in tax
1923	$9,243.66
1924	None
Total	$9,243.66

The report of the internal-revenue agent in charge at Chicago, Illinois, transmitted to this office under date of May 14, 1927, has been reviewed and approved with the following exception:

1923

As a result of the reduction in the 1919 earning of the West Side Lumber Company by $81,200.00, representing stock dividends, it has been determined that your dividends received from this source in 1923 were 28.217% instead of 29.81%. This adjustment reduces the proposed deficiency from $10,437.93 to $9,243.66.

Payment of the tax in question should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

11 *Exhibit "B" to petition*

TREASURY DEPARTMENT,
Washington, Aug. 25, 1927.

(Seal) Office of Commissioner of Internal Revenue.

Address reply to Commissioner of Internal Revenue and refer to IT:FAR:B-1 RRP.

Mr. ANDREW L. CAMPBELL,
105 South La Salle Street, Chicago, Illinois.

In re: Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois.

SIR: Reference is made to your letter dated August 10, 1927, relative to a proposed additional tax of $10,437.93 against the above-named individual for the year 1923.

In accordance with your request the computations, showing how it was determined that the dividends of the West Side Lumber Company were 29.81% taxable, are set forth below.

Your attention is called to the fact that net losses incurred in any year do not affect earnings available for dividends, in accordance with the decision of the United States Court of Claims in the case of Frank P. Blair vs. the United States.

In G. C. M. 1386, Bulletin VI(27)-12, page 2, it is held that under the revenue acts the corporate earnings of the entire year should be taken as a unit in determining the amount available for dividends, and not merely the earnings up to the date a dividend was paid.

It will be noted that the figures used are those which resulted from the final office adjustments of the corporation returns.

12 *Statement of West Side Lumber Company, surplus account, March 1, 1913, to March 1, 1924*

Surplus, March 1, 1913		$4,332,684.78	
Subsequent earnings, profit from operations (per final office adjustments):			
Year ending February 28, 1914		$4,594.62	
Year ending February 28, 1915		(193,139.67)	Loss.
Year ending February 28, 1916		(211,707.32)	Loss.
Year ending February 28, 1917		60,495.56	
Year ending February 28, 1918		57,901.55	
Year ending February 28, 1919		289,937.34	
Year ending February 28, 1920		543,490.33	
Year ending February 28, 1921		640,837.43	
Year ending February 28, 1922		182,954.63	
Year ending February 28, 1923		718,858.29	
Year ending February 28, 1924		311,209.54	(per G.C.M. 1386).
Total earnings available for dividends		$2,810,279.29	
Less dividends paid:			
Year ending February 28, 1918	$90,000.00		
Year ending February 28, 1919	450,000.00		
Year ending February 28, 1922	300,000.00		
Year ending February 28, 1923	450,000.00		
		1,290,000.00	
Surplus, February 28, 1924		$1,520,279.27	
Dividend declared April 14, 1923		5,100,000.00	
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		$3,579,720.71	

From these figures it will be seen that $1,520,279.24, or 29.81% of the dividend paid on April 14, 1923, represents taxable income.

You are advised that a copy of this letter is being forwarded to the internal revenue agent in charge at Chicago, Illinois.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By PORTER LINDER,
Head of Division.

13 *Exhibit "C" to petition*

(960M) Form NP-1a

TREASURY DEPARTMENT,
Washington, July 9, 1927.

(Seal) Office of Commissioner of Internal Revenue.

Address reply to Commissioner of Internal Revenue and refer to IT:PA:1:LVH.

Mr. CHARLES J. CANFIELD,
199 Lake Shore Drive, Chicago, Illinois.

SIR: An audit of your income-tax returns for the years 1923 and 1924, in connection with the report dated May 14, 1927, of the in-

ternal-revenue agent in charge at Chicago, Illinois, disclosed a deficiency of $10,437.93 for the year 1923, as shown in the attached statement.

Enclosed you will find a statement indicating adjustments proposed by this office based upon recommendations of the revenue agent above indicated. If you acquiesce in the proposed adjustments as shown in this letter and the accompanying statement, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:PA:1:LVH. In the event that you acquiesce in a part of such proposed adjustments the form should be executed with respect to the items to which you agree.

If, however, you do not acquiesce, you are granted 30 days from the date of this letter within which to present a protest with the internal-revenue agent in charge, 426 Federal Building, at Chicago, Illinois, against the adjustments proposed herein. The protest and any additional statements of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of
14 an individual the residence, and in the case of a corporation the principal office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of the proposed adjustments with respect to which the protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (e) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the date of mailing of the registered letter (not counting Sunday as the sixtieth day) in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By E. A. COOK,
Acting Head of Division.

Enclosures:
Statement
Form A
Form 882.

Statement

IT:PA:1:LVH JUL. 9, 1927.

In re: Mr. Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois.

Year	Deficiency in tax
1923	$10,437.93
1924	None

The report dated May 14, 1927, of the internal-revenue agent in charge at Chicago, Illinois, has been reviewed and approved except as follows:

15 The dividends of $204,000.00 received by you on April 14, 1923, from the West Side Lumber Company have been determined to be 29.81% taxable. Your taxable dividends from this source are, therefore, $60,812.00 instead of $33,360.00 as shown in the report.

This adjustment increases your total net income to $169,108.86, and indicates a deficiency as shown by the following computation:

Total tax		$63,590.53
Less:		
25% reduction, Revenue Act of 1924	$15,897.63	
Tax paid at source	32.40	
		15,930.03
Balance		47,660.50
Tax assessed	49,630.09	
Less: 25% reduction, Revenue Act of 1924	12,407.52	
		37,222.57
Deficiency		10,437.93

Payment of the deficiency in tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Before U.S. Board of Tax Appeals

Answer

Filed March 17, 1928

Comes now the Commissioner of Internal Revenue, by his attorney C. M. Charest, general counsel, Bureau of Internal Revenue, and for answer to the petition of his taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.

4(I) to 4(IX), inclusive. Denies the averments contained
16 in subparagraphs (I) to (IX), inclusive, of paragraph 4 of the petition.

5(a). Admits that the petitioner filed its return for the year 1923 on or about March 14, 1924, and that such return showed a net taxable income of $140,656.86. Admits that the petitioner reported thereon an item of $33,360.00, representing dividends. Denies each and every other material allegation of fact set forth in paragraph 5(a) of the petition.

5(b). Admits that the West Side Lumber Company is a California corporation. For lack of information denies each and every other material allegation of fact set forth in paragraph 5(b) of the petition.

5(c)(d). Denies the material allegations of fact contained in paragraph 5, subparagraphs (c) and (d) of the petition.

5(e). Admits that in April 1923 the West Side Lumber Company paid a dividend of $5,100,000.00 or $340.00 a share. Admits that petitioner received in such distribution the sum of $204,000.00. Admits that the petitioner reported as income from such distribution the sum of $33,360.00. Denies each and every other material allegation of fact set forth in paragraph 5, sub-paragraph (e) of the petition.

5(f)(1)(2)(3). Admits that the Commissioner determined that the income derived by the petitioner from 600 shares of stock in 1923 was 28.217% taxable and that the petitioner should have returned as taxable income therefrom the sum of $57,562.68. Admits that the deficiency of $9,243.66 is computed on the basis of including in the petitioner's taxable income the sum of $57,562.68 instead of $33,360.00. Denies each and every other material allegation of fact set forth in paragraph 5, subparagraph (f) (1), (2) (3), of the petition.

Denies generally and specifically each and every allegation of error and of fact contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
BENTON BAKER,
Special Attorney,
Bureau of Internal Revenue.

17 Before U.S. Board of Tax Appeals

Memorandum of facts

Filed at Hearing Oct. 30, 1930

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that for the purpose of this proceeding the following facts may be accepted as true:

1

The items of gross income, the deductions therefrom, and the net income shown in petitioner's 1923 return were as follows:

Gross income		
Interest received		$120,880.63
Dividends received		39,367.00
		$160,247.63
Deductions		
Partnership losses	$3,735.47	
Interest paid	14,391.48	
Taxes paid	137.79	
Bad debts	1,000.00	
Office expenses	326.03	
		19,590.77
Net income shown in petitioner's 1923 return		$140,656.86

2

The item of dividends amounting to $39,367.00 included in gross income in the petitioner's 1923 return consisted of:

Dividends received from the West Side Lumber Company on or about February 12, 1923, amounting to $10 a share on 600 shares, or	$6,000.00
Dividends received from the West Side Lumber Company on or about April 14, 1923, amounting to $340.00 a share on 600 shares, or $204,000 of which the petitioner reported as taxable income, an amount equal to $55.60 per share on 600 shares, or	33,360.00
Dividends received from other corporations	7.00
Total taxable dividends shown in petitioner's 1923 return	$39,367.00

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3

The determination of tax set forth in the Commissioner's notice of deficiency was arrived at by the computations shown in exhibits A, B, and C, attached to the petition, which are true and correct copies of the Commissioner's letters dated November 25, 1927, August 25, 1927, and July 9, 1927, respectively.

4

The computation by which the Commissioner has determined that the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 28.217% taxable is as follows:

Statement of West Side Lumber Company surplus account, March 1, 1913, to March 1, 1924

Surplus March 1, 1913		$4,332,684.78
Subsequent earnings:		
Year ended February 28, 1914, profit		4,594.62
" " February 28, 1915, loss	$193,139.67	
" " February 29, 1916, loss	211,707.32	
" " February 28, 1917, profit		60,495.50
" " February 28, 1918, profit		57,901.55

Subsequent earnings—Continued.		
Year ended February 28, 1919 profit		$208,737.34
" " February 29, 1920, profit		543,490.33
" " February 28, 1921, profit		640,837.43
" " February 28, 1922, profit		182,954.63
" " February 28, 1923, profit		718,858.29
" " February 29, 1924, profit		311,209.54
Total earnings available for dividends		$2,729,079.29
Less dividends paid:		
Year ended Feb. 28, 1918	$90,000.00	
" " " " 1919	450,000.00	
" " " " 1922	300,000.00	
" " " " 1923	450,000.00	
		1,290,000.00
Surplus February 28, 1924 (28.217% of $5,100,000)		1,439,079.29
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		3,660,920.71

5

The respondent concedes that the foregoing computation should be revised to show that the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 22.75% taxable instead of 28.217% taxable, determined as follows:

19 *Statement of West Side Lumber Company surplus account, March 1, 1913 to April 14, 1923*

Surplus March 1, 1913		$4,332,684.78
Add profit for year ended Feb. 28, 1914		4,594.62
		4,337,289.40
Deduct:		
Loss for year ended Feb. 28, 1915	$193,139.67	
" " " " " " 1916	211,707.32	
		404,846.99
Surplus February 29, 1916		3,932,442.41
Subsequent earnings:		
Year ended Feb. 28, 1917		60,495.56
" " " 28, 1918		57,901.55
" " " 28, 1919		208,707.34
" " " 29, 1920		543,490.33
" " " 28, 1921		640,837.43
" " " 28, 1922		182,954.63
" " " 28, 1923		718,858.29
Period ended April 14, 1923 (44/366 of total earnings of $311.209.54 for year ended Feb. 29, 1924)		37,418.17
Total earnings March 1, 1916 to April 14, 1923		2,450,658.30
Less dividends paid:		
Year ended Feb. 28, 1918	$90,000.00	
" " " 28, 1920	75,000.00	
" " " 28, 1921	375,000.00	
" " " 29, 1932	300,000.00	
" " " 28, 1923	450,000.00	
		1,290,000.00
Surplus March 1, 1916 to April 14, 1923, (22.75% of $5,100,000)		1,160,658.30
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (non-taxable)		$3,939,341.70

The capital stock of the West Side Lumber Company during the period from March 1, 1913, to April 14, 1923, consisted of 15,000 shares having a par value of $100 each. The petitioner owned 600 shares of said capital stock during all of such period.

The surplus of the West Side Lumber Company and its earnings, losses, and dividends for the period from March 1, 1913, to April 14, 1923, were as follows:

Statement of West Side Lumber Company surplus account March 1, 1913 to April 14, 1923

Surplus March 1, 1913		$4,332,684.78
Subsequent earnings:		
Year ended Feb. 28, 1914, profit	$4,594.62	
" " " 28, 1915, loss	(193,139.67)	
" " " 29, 1916, loss	(211,707.37)	
" " " 28, 1917, profit	60,495.56	
" " " 28, 1918, profit	57,901.55	
" " " 28, 1919, profit	208,737.34	
" " " 29, 1920, profit	543,490.33	
" " " 28, 1921, profit	640,837.43	
" " " 28, 1922, profit	182,954.63	
" " " 28, 1923, profit	718,858.29	
Period ended April 14, 1923, (44/366 of total earnings for year ended February 29, 1924)	37,413.17	
		2,050,435.93
		6,383,120.71
Dividends paid:		
Year ended Feb. 28, 1918, $6	90,000.00	
" " " 29, 1920, 5	75,000.00	
" " " 28, 1921, 25	375,000.00	
" " " 28, 1922, 20	300,000.00	
September 15, 1922, 10	150,000.00	
" 18, 1922, 10	150,000.00	
February 12, 1923, 10	150,000.00	
		1,290,000.00
Surplus April 14, 1923		$5,093,120.71

21 On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock, of which petitioner received $204,000.

The right is hereby reserved by both parties to prove any additional facts not inconsistent herewith.

CHARLES J. CANFIELD, *Petitioner.*
By ANDREW L. CAMPBELL, *Attorney.*
COMMISSIONER OF INTERNAL REVENUE,
By C. M. CHAREST, *Attorney.*

Before U. S. Board of Tax Appeals

Promulgated June 12, 1931

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The

corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

Edwin H. Cassels, Esq., and Andrew L. Campbell, C.P.A., for the petitioners.

Harold Allen, Esq., and Willis R. Lansford, Esq., for the respondent.

The Commissioner determined a deficiency in income tax for 1923 of $9,243.66 in Docket No. 34131 and of $36,720.96 in Docket No. 38095, the full amount of such deficiencies being in controversy.

These proceedings are consolidated for hearing, the issue,
22 which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

Findings of fact

Filed June 12, 1931

The petitioners are individuals, Charles J. Canfield, residing and having his principal office in Chicago, Ill., and William R. Thorsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

23 The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00
September 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000 or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5.455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 percent

taxable, instead of being 28.217 percent taxable in the case of Charles J. Canfield and 25.05 percent taxable in the case of William R. Thorsen, as formerly asserted.

The petitioners contend that said dividend distribution was
24 only 14.91 percent taxable and that each reported originally more taxable income than he should have returned.

Opinion

Filed June 12, 1931

SEAWELL: The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

"SEC. 201. (a) That the term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the act exempt from the tax; that the surplus so created and existing cannot be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913", which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913", as considered in O.D. 610, C.B. 3, p. 24, and A.R.M. 82, C.B. 3, p. 36, and as likewise construed by the respondent and applied in the instant cases.

25 The respondent in making his determination excludes from consideration for the period "since February 28, 1913", the losses sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended February 29, 1916, of $211,707.32. To March 1,

1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40, from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,658.30, which respondent considers the total earnings or profits from February 28, 1913, to April 14, 1923. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,658.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000. The difference, $3,939,341.70, between the $1,160,658.30 and the $5,100,000 declared and paid as a dividend April 14, 1923, represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as *dividends in the hands of the* recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen $1,111,800, and if the respondent's method of tax computation is correct, each of the petitioners is taxable on 22.75 percent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

It is ably and plausibly argued in behalf of petitioners that the respondent has erred in his method of computation of the deficiency in tax and numerous authorities are cited to support such contention.

In considering the question it should be constantly borne in mind that in the instant cases the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78, in addition to its capital of $1,500,000.

In the year ended February 28, 1914, the company made a profit of $4,594.62 and if it had then, out of its total earnings or surplus, declared a dividend and made distribution in excess of the $4,594.62 and less than the entire surplus, the difference between the $4,594.62 and the dividend so declared would not have been taxable in the hands of stockholders, but only the amount of the earnings, $4,594.62, accumulated, since March 1, 1913, would have been taxable. In such circumstances there would apparently be no disagreement between the petitioners and the respondent as to the taxable amount and there appears to be no objection on the part of the petitioners to the manner in which the earnings or profits for the year ended February 28, 1914, were dealt with by respondent in his computation. How the losses occurring in the years ended on the last days of February 1915 and 1916 are to be considered in determining the amount of "earnings and profits accumulated since February 28, 1913", under section 201 (b) of the act, is the real issue between the parties.

In the years ended on the last days of February 1915 and 1916 the West Side Lumber Company sustained losses aggregating $404,-846.99. At the time such losses were sustained, however, they did not in fact produce an operating deficit, for the reason there were then the $4,594.62 above mentioned prior undistributed accumulated earnings or profits constituting a surplus much greater in amount than such losses and made good the same, leaving thereafter a surplus on the last day of February 1916 of $3,932,432.41. The capital of $1,500,000 was not impaired by such losses.

The evidence shows there were no losses by the West Side Lumber Company after the year ended February 29, 1916; that its total earnings March 1, 1916, to April 14, 1923, were $2,450,658.30, and there were dividend distributions of $1,290,000 prior to the latter date, on which date a dividend of $5,100,000 was declared and distributed to its stockholders, of which petitioners were two, receiving the amounts indicated in our findings of fact.

In support of petitioners' insistence that the respondent erred in his method (fully set forth in the evidence) of computing their taxable income for the year in issue, decisions in numerous cases are cited. We do not deem it necessary to discuss in detail all the cases cited and relied on by the petitioners. The questions involved and the facts stated in many of the cases are quite different from those in the instant cases. We will, however, comment very briefly on some of such cases, though none, in our opinion, is controlling.

Mutschler Bros. Co., 12 B.T.A. 731, is a case concerning the
27 restoration of capital impairment through undivided profits and involves a question of invested capital, and the brief of the petitioners states the decision therein followed the decision in Willcuts v. Milton Dairy Co., 275 U.S. 215. The facts and basic principles, however, are not the same as in the instant cases and, in our opinion, do not warrant the interpretation placed upon them by petitioner.

Southern Pac. Co. v. Lowe, 247 U.S. 330, involved surplus accumulations which accrued to a corporation prior to January 1, 1913, and were in the circumstances of that case held to be capital and not income, and does not distinguish between an accumulation of surplus earnings and the increment due to an appreciation in value of the assets of the corporation.

The case of Park v. Gilligan, 293 Fed. 129, involved a distribution as a dividend of the proceeds of a chose in action arising prior to March 1, 1913. It was held therein that an amount received in 1916 in settlement of a claim for damages existent on March 1, 1913, is not profit arising subsequent to that date. All current earnings having been distributed previously, those distributed to the shareholders after March 1, 1913, were held not to constitute a taxable dividend under the Revenue Act of 1916.

Crystal Ice Co., 14 B.T.A. 688, involved consideration of the effect on invested capital of the payment of dividends where a deficit exists

due to operation losses, the dividends having been paid before such deficit was made good. The case is not like the instant cases and no authority in support of petitioners' contention.

The case of J. L. Washburn, 16 B.T.A. 1091, is not in point, for the reason that it involves the taxability of a dividend where on the date of the distribution the corporation paying the same had a deficit in its surplus account.

In Louise Glassell Shorb, 22 B.T.A. 644, we indicated our opinion of the correctness of certain rulings of the Bureau of Internal Revenue in the matter of determining whether certain corporate distributions were taxable dividends and among the number of such rulings was G.M.C. 3532, C. B. VII-1, 190, in compliance with which the respondent has determined the taxability of distributions made by the West Side Lumber Company to petitioners in the instant cases.

The respondent, in support of his position and determination herein, relies on the case of Blair v. United States, 633 Ct. Cl. 193 (certiorari denied, 275 U.S. 546), upon which he also relied in the Shorb case, supra, and in which case we held that the Blair
28 case was not applicable and was distinguishable therefrom on the facts. In the Washburn and Shorb cases, supra, at the date of the distribution in the taxable years in question there were in fact no accumulated earnings or profits, no surplus from which to pay dividends and the distributions were, therefore, held to be made out of capital and did not constitute taxable income to the recipients.

In the instant cases, there was no operating deficit but, at the time the losses aggregating $404,846.99 occurred in the taxable years of 1914 and 1915, there was an undivided surplus of several million dollars mostly accumulated prior to March 1, 1913, and after which date there were accumulated earnings or profits in excess of all the dividends distributed to the stockholders prior to the $5,100,000 dividend paid April 14, 1923, of which dividend only a portion, as heretofore indicated, was determined taxable by the respondent. In the Blair case, supra, the corporation, as in the instant cases, had a surplus March 1, 1913, which was reduced by losses occuring in 1913, 1914, and 1915, creating a deficit December 31, 1915, which was overcome by earnings in 1916, 1917, and 1918, leaving a balance of accumulated earnings of the latter three years, more than sufficient to pay the dividend declared December 1918, which was held to be taxable income in the hands of the recipient stockholders.

The situation in the instant cases is similar in that the West Side Lumber Company had a surplus March 1, 1913, with losses in the two following years and earnings thereafter in the subsequent years more than sufficient to pay all dividends prior to that of April 14, 1923, of $5,100,000, and to the extent it was insufficient to pay said dividend, the amount received by petitioners was by the respondent considered exempt from income tax, being held no part of the "earnings or profits accumulated since February 28, 1913."

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber

Company on April 14, 1923, was 22.75 percent taxable instead of 28.217 percent taxable, but insists upon the application in the instant cases of the principle heretofore approved as indicated in the Shorb case, supra, and sustained in the Blair case, supra.

We are of the opinion that the deficiencies proposed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct

Judgment will be entered in each case under rule 50.

28a "The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made, and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board."

24 B.T.A. —

Filed Oct. 27, 1931

Before United States Board of Tax Appeals

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

WILLIAM R. THORSEN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 34131, 38095. Promulgated October 27, 1931

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the

extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

Edwin H. Cassels, Esq., and Andrew L. Campbell, C.P.A., for the petitioners.

Harold Allen, Esq., and Willis R. Lansford, Esq., for the respondent.

28b The Commissioner determined a deficiency in income tax for 1923 of $9,243.66 in Docket No. 34131 and of $36,720.96 in Docket No. 38095, the full amount of such deficiencies being in controversy.

These proceedings are consolidated for hearing, the issue, which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

Findings of fact

Filed Oct. 27, 1931

The petitioners are individuals, Charles J. Canfield residing and having his principal office in Chicago, Ill., and William R. Thorsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
" " 1915		$193,139.67
" 29, 1916		211,707.32
" 28, 1917	60,495.56	
" " 1918	57,901.55	
" " 1919	208,737.34	
" 29, 1930	543,490.33	
" 28, 1921	640,837.43	
" " 1922	182,954.63	
" " 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended Feb. 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

28c The difference between the profits and losses of the several years set forth is $2,050,435.93.

The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$90,000.00
" " " 29, 1920	75,000.00
" " " 28, 1921	375,000.00
" " " 28, 1922	300,000.00
September 15, 1922	150,000.00
" 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5,455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 percent taxable, instead of being 28.217 percent taxable in the case of Charles J. Canfield and 25.05 percent taxable in the case of William R. Thorsen, as formerly asserted.

28d The petitioners contend that said dividend distribution was only 14.91 percent taxable and that each reported originally more taxable income than he should have returned.

Opinion

Filed Oct. 27, 1931

SEAWELL: The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

"SEC. 201. (a) That the term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the act exempt from the tax; that the surplus so created and existing cannot be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913", which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913", as considered in O.D. 610, C.B. 3, p. 24, and A.R.M. 82,
28e C.B. 3, p. 36, and as likewise construed by the respondent and applied in the instant cases.

The respondent in making his determination excludes from consideration for the period "since February 28, 1913", the losses (except to the extent of $4,594.62, profits for the year ending February 28, 1914), sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended February 29, 1916, of $211,707.32. To March 1 1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40, from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,688.30. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,688.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000.

The difference between the $1,160,688.30 and the $5,100,000 declared and paid as dividend April 14, 1923, is $3,939,311.70 and represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as dividends in the hands of the recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen $1,111,800, and if the respondent's method of tax computation is correct, each of the petitioners is taxable on 22.75 percent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

In the year ended February 28, 1914, the company made a profit of $4,594.62, and if it had then, out of its total earnings or surplus, declared a dividend and made distribution even in excess of the $4,594.62, but less than the entire surplus, the whole dividend would have been taxable to the recipients thereof. The revenue law exempting from taxation dividends declared out of earnings accumulated prior to March 1, 1913, was not enacted until September 8, 1916. In Lynch v. Hornby, 247 U.S. 399 (decided June 3, 1918), the court said:

> We repeat that under the 1913 act dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

No dividend was declared, however, out of the earnings for the year ending February 28, 1914, and it was accordingly proper for the corporation to add that sum, $4,594.62, to its accumulated surplus, bringing it to the sum of $3,337,279.40. When in the two succeeding years there were operating losses by the corporation charged, of course, against surplus, the surplus was reduced by the sum of the losses, $404,846.99, resulting in a new surplus on February 29, 1916, of $3,932,432.41.

The treatment to be accorded this new surplus and the earnings and profits thereafter accumulated by the corporation contains the matter in controversy here. The petitioners contend that since the new surplus is less than the surplus existing at March 1, 1913, all subsequent earnings and profits of the corporation should be added to this new surplus until it equals the surplus on hand at March 1, 1913, before dividends paid to stockholders are taxable.

In other words, the petitioners contend that they are not taxable on any dividend declared and paid at any time after March 1, 1913, although the corporation has had gain in that period, if for any cause, the corporation's surplus is less than what it was on that basic date; and they urge on us the construction of the clause of the statute "earnings or profits accumulated since February 28, 1913", that a period of all the years since March 1, 1913, should be considered together to ascertain whether there have been net accumula-

tions for the whole period. It is elementary that the different parts of a statute are to be considered in pari materia. Certainly no part of a statute should be so interpreted as to annul any other part. When the statute provides that "every distribution is made * * * from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913", there is implied that some earnings or profits may belong to a class accumulated more recently than others. If all the years since March 1, 1913, are to be taken together and additions and subtractions made to ascertain if earnings or profits have "accumulated" and the amount thereof during the period, then there would
28g not seem to be much reason for ascertaining the nearness or remoteness of such earnings or profits. It could make no difference whether the distributions or dividends were from the most recent or most remote accumulations, since they all lie in one hodge-podge. Surely Congress had some reason for inserting in the statute the provision as to the most recent accumulations. All income-taking statutes under the sixteenth amendment are based on yearly periods, either calendar or fiscal years. Returns are so made out and gains and losses calculated so as to show profit or loss during the year, and for such a period it is immaterial which part of the gain is more recent or remote. It would seem singular if Congress did adopt the yearly period in taxation matters for all times and under all circumstances, except at the time of the enactment of the statute now under consideration and then only for part of the statute. It is more consonant with reason to suppose that Congress, when it provided for "accumulations since February 28, 1913", had reference to accumulations in yearly periods. A contrary interpretation of the taxing law has been sought without success. In Edwards v. Douglas, 269 U.S. 204, 217, the court said, in interpreting similar provisions of the Revenue Act of 1917, section 31 (b):

"* * * To acocmplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." * * *"

The Supreme Court in another case later said:

"* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or loss."

Burnet v. Sanford & Brooks Co., 282 U.S. 359.

The only losses of the West Side Lumber Company were
28h for the years ending February 28, 1915, and February 29, 1916.
The petitioners, who received dividends in 1923 from the corporation, contend in effect that the losses for those two years should be carried forward and deducted from gains in the years ending February 28, 1917, 1918, 1919, and 1920. The Revenue Act of 1918, section 204, permitted a net loss in one year to be carried to the preceding year to reduce the income in that year, and if in excess of such income for the preceding year, to have such excess carried forward to the succeeding year for a similar purpose as to the income in the succeeding year. But we know of no such provision of law applicable to the years here involved, and the act of 1918 is not retroactive, or claimed by petitioners so to be. There was at the times of these losses, which aggregate $404,846.99, no operating deficit of the corporation, but an undivided surplus, as before stated, of $4,337,279.40, all of which, except $4,594.62, was accumulated prior to March 1, 1913. The undivided surplus, therefore, was adequate to take care of the operating losses in the two years mentioned, without in any way impairing the capital of the corporation, which amounted to $1,500,000.

The petitioners cite two recent court decisions which they insist sustain their contentions, viz, Leland v. Commissioner, 50 Fed. (2d) 523, and Hadden v. Commissioner, 49 Fed. (2d) 709. In the Leland case, first cited, the Board of Tax Appeals, 18 B.T.A. 795, is affirmed. In the opinion of the court it is said:

"Then again, as the Leland-Gifford Company had on hand, at the time the distributions were made, earnings or profits that had accumulated since 1913, we do not think that the provisions of section 201 (c) of the Revenue Act of 1921 and 1924 are applicable."

This case does not appear to be an authority for the petitioner. In the case of Hadden v. Commissioner, supra, the corporation never had a surplus, but operating losses from its organization in 1904, in each year until April 30, 1917, at which time the net deficit was $833,862.92. The total losses between March 1, 1913, and April 30, 1917, were $329,549.22. From April 30, 1917, to December 20, 1917, by the sale of capital assets, it had a taxable profit of $405,949.07. The court held that the operating losses or carrying charges after March 1, 1913, should be deducted from the profits of December 20, 1917, before dividends declared and paid out of such taxable profits were taxable to the stockholders receiving the dividends.

What the court would have held if, as in the case at bar, the
28i corporation had had accumulated surplus and undivided profits sufficient to have absorbed all the losses before the profits by sale of the capital assets were realized, it is mere speculation to surmise; but the facts in that case are so different in material respects from those in the instant case that we do not feel impelled to follow certain of the language used by the learned judge

who delivered the opinion, even though it might be broad enough to include a situation comparable to that before us.

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 28.217 per cent taxable, but insists upon the application in the instant cases of the principle adopted and maintained for many years by the Bureau of Internal Revenue and set forth in G.C.M. 3532, C.B. VII-1, 190, which position we think correct and we so expressed ourselves in Louise Glassell Shorb, 22 B.T.A. 644, 645, in which case the Commissioner had taken an opposite view. We are of the opinion that the principle so approved is also sustained in *Blair* v. *United States*, 63 Ct. Cls. 193; certiorari denied 275 U. S. 546.

We are of the opinion that the deficiencies proposed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct.

Reviewed by the Board.

Judgment will be entered in each case under rule 50.

Dissenting opinion

TRAMMELL, dissenting: It seems to me too clear for controversy that any surplus existing at February 28, 1913, has no connection whatever with what the accumulated surplus since that date is. What the majority opinion holds might be illustrated as follows: If a taxpayer had an earned surplus of $10,000 on February 28, 1913, and subsequent to that date had earnings in some years, and losses in others, and at the end of 1920 the total losses since February 28, 1913, equaled its total earnings since that date, with the result that at that time there were no earnings in fact accumulated since 1913, a distribution at the close of 1920 would be held to be out of the earnings or profits accumulated since February 28, 1913. In other words, the losses since February 28, 1913, are applied against the surplus existing on that date. Yet in the illustration given
28j it is perfectly plain that the only surplus to be distributed was that existing on February 28, 1913. This, in my opinion, results in taxing the surplus existing on February 28, 1913, when distributed in dividends, contrary to the statute. In my opinion there can be no accumulated surplus since February 28, 1913, unless the earnings since that date exceed the losses since that date. These are the only factors to be considered. I see no occasion to apply losses since 1913 to surplus at that time in order to ascertain the accumulated earnings since February 28, 1913. This is quite different from the principle of determining earned surplus for invested capital purposes, where there is no requirement to determine accumulated surplus since a certain date, but only the question as to the total earned surplus existing in the taxable year or on hand

when that year began. See *Willcuts* v. *Milton Dairy Co.*, 275 U. S. 215. I believe the statute should be construed according to its plain language, that is, the distribution to be taxable must be out of earnings or profits accumulated since February 28, 1913, and that such amount should not be affected in any way by any surplus existing at that time.

The losses since February 28, 1913, should be taken from the profits since that date to determine the accumulated profits since that date.

I do not thing the *Shorb* case in 22 B.T.A. 644, is authority for the majority decision. The corporation in that case was not organized until after March 1, 1913.

The prevailing opinion also relies on the case of *Blair* v. *United States*, 63 Ct. Cls. 193 (A.F.T.R. 6552). In the case of *J. L. Washburn*, 16 B.T.A. 1091, the Board pointed out that it considered the *Blair* case to be unsound and declined to follow it.

In the case of *Hadden* v. *Commissioner*, 49 Fed. (2d) 709 (A.F.T.R., vol. 9, 1497), the Circuit Court of Appeals for the Second Circuit, said:

"The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *."

I think this view is correct and that it is erroneous to reduce the surplus on hand on February 28, 1913, by subsequent losses to determine the earnings and profits accumulated since that date.

MORRIS, MARQUETTE, SMITH, STERNHAGEN, LOVE, and MCMAHON agree with this dissent.

28k [Clerk's Certificate to foregoing paper omitted in printing.] (pp. 28a to 28k inserted per order of June 15, 1932.)

29 United States Board of Tax Appeals, Washington

Docket No. 34131

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Entered Dec. 12, 1931

Pursuant to the findings of fact and opinion of the Board promulgated October 27, 1931, the respondent on November 23, 1931, filed notice of settlement under rule 50. Copy of said notice having been served on the petitioner and the petitioner on December 16, 1931, having filed notice of acquiescence to the proposed settlement, it is

Ordered and decided: That there is a deficiency in tax for the year 1923 in the amount of $5,145.19.

Enter:

(Signed) M. F. SEAWELL,
Member.

A True Copy:
Teste:
[SEAL]

B. D. GAMBLE,
Clerk U.S. Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review

Filed Feb. 1, 1932

Comes now Charles J. Canfield, by Edwin H. Cassels and Barry Gilbert, his attorneys, and respectfully shows unto this court that:

A

1. The petitioner is a citizen of the United States and of the State of Illinois, with his residence in Chicago, Cook County, Illinois.

2. On or about the 14th day of March 1924, the petitioner
30 filed in the office of the collector of internal revenue at Chicago, Illinois, his detailed income tax return for the calendar year 1923 and reported therein a net taxable income of $140,656.86 for said year 1923. Included in such return was an item of $33,360, returned as taxable income from a certain dividend received by him on or about April 14, 1923, from West Side Lumber Company, a California corporation.

3. The petitioner also reported in his said 1923 return certain other dividends received from West Side Lumber Company on or about February 12, 1923, amounting to $6,000. There is no dispute with respect to the correctness of such return as to said dividend of February 12, 1923.

4. West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares, having a par value of $100 each. The petitioner during all of such period owned 600 shares of said capital stock.

5. In addition to its said original capital of $1,500,000, West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78 and the book value of its common stock was on that date $388.85 per share.

6. On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913, so that the book value of the common stock on April 14, 1923, was $439.54 per share.

7. The earnings and losses of the company after March 1, 1913, were as follows:

Year ending	Profits	Losses
February 28, 1914	$4,594.62	
" 28, 1915		$193,139.67
" 29, 1916		211,707.32
" 28, 1917	60,495.56	
" 28, 1918	57,901.55	
" 28, 1919	208,737.34	
" 29, 1920	543,490.33	
" 28, 1921	640,837.32	
" 28, 1922	182,954.63	
" 28, 1923	718,858.29	
March 1, 1923 to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
Total	$2,455,282.92	$404,846.99

31 The difference between the profits and losses of the several years set forth is $2,050,435.93.

8. The following dividends were paid by West Side Lumber Company after February 28, 1913:

Period	Per share	Amount
Year ended Feb. 28, 1918	$6	$90,000.00
Year ending Feb. 29, 1920	5	75,000.00
Year ended Feb. 28, 1921	25	375,000.00
Year ended Feb. 28, 1922	20	300,000.00
September 15, 1922	10	150,000.00
September 18, 1922	10	150,000.00
February 12, 1923	10	150,000.00
		$1,290,000.00

9. On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock. The petitioner received from this source from his said 600 shares the sum of $204,000. The issues in this case concern the taxable income due from the said Charles J. Canfield with respect to this payment received by him.

10. The Commissioner of Internal Revenue, by his letter dated August 25, 1927, addressed to the petitioner, found that of the said $5,100,000 paid by the said dividend of West Side Lumber Company of April 14, 1923, $3,579,720.71 was paid out of surplus earned prior to March 1, 1913, and that the balance thereof, or $1,520,279.29, was paid out of the earnings of such company accumulated after February 28, 1913. This latter amount is 29.81% of the dividend paid on April 14, 1923. The Commissioner in such letter declared that such 29.81% of the dividend of April 14, 1923, represented taxable income to the petitioner under the provisions of section 201 of the Internal Revenue Act of 1921.

11. Thereafter, on November 25, 1927, the Commissioner of Internal Revenue issued and mailed to the petitioner a deficiency letter from which the appeal to the Board of Tax Appeals hereinafter mentioned was prosecuted, and therein determined that the earnings accumulated after February 28, 1913, by West Side Lumber Com-

pany were $1,439,079.29, or 28.217% of the dividend paid on April 14, 1923, and that the petitioner was therefore taxable under the provisions of section 201 of the Internal Revenue Act of 1921

32 upon 28.21% of the dividend of $340 per share, or $57,562.68, received with respect to his said 600 shares.

12. In his said income-tax return for the said calendar year of 1923 the petitioner had reported as taxable income the amount of $55.60 per share under his interpretation of section 201 of said Internal Revenue Act of 1921. The said sum of $57,562.68 arrived at by the said Commissioner amounted to $95.9378 per share. The issues thus presented between the Commissioner and this petitioner as a result of said deficiency letter were as to whether or not the difference between these two sums per share, on each of said 600 shares, or $40.3378 per share, constituted taxable income to the petitioner for the year 1923.

13. Thereafter, the petitioner appealed from said determination of said Commissioner to the United States Board of Tax Appeals (Docket No. 34131). The said Commissioner duly appeared therein and filed a stipulation that his prior computations set forth in said letters of August 25, 1927, and November 25, 1927, were incorrect and that the said dividend of $340 per share paid by West Side Lumber Company on April 14, 1923, to this petitioner, with respect to each of his said 600 shares, was not to exceed 22.75% taxable, or at the rate of $77.35 per share or a total of $46.410.

14. Thereafter, the appeal of the petitioner was duly heard by said Board of Tax Appeals, which, on, to wit, the 27th day of October, 1931, promulgated its findings of fact and opinion in said proceeding and therein found and gave its opinion (eight members of said Board concurring therein and seven members of said Board dissenting therefrom) that said dividend of $340 per share paid by West Side Lumber Company to this petitioner on April 14, 1923, with respect to each of his said 600 shares was 22.75% taxable.

15. The Board ordered that judgment be entered in said case under rule 50 of said Board of Tax Appeals and pursuant thereto an order was subsequently entered finding that the total tax due from this petitioner for said year 1923 was $42,367.76, of which $37,222.57 had been previously assessed, leaving a balance of $5,145.19 for which judgment was entered by said Board under said rule 50.

16. This petitioner claims that:

(a) This case is governed by section 201 of the Internal Revenue Act of 1921.

(b) West Side Lumber Company was entitled thereunder

33 to distribute tax free all earnings and profits accumulated or increase in value in property accrued prior to March 1, 1913. Such earnings or profits were a sum equivalent to its surplus on February 28, 1913, namely, $4.332,684.78, and this sum was therefore distributable exempt from tax.

(c) The "earnings and profits" of West Side Lumber Company for the period March 1, 1913, to April 14, 1923, inclusive, were the difference between the total profits of the parts of such period in which profits were made ($2,455,282.92), and the total losses for the parts of such period in which losses were sustained ($404,846.99),

namely, $2,050,435.93. These net earnings so computed were the "earnings and profits" of West Side Lumber Company "accumulated since February 28, 1913," within the meaning of section 201 of the Internal Revenue Act of 1921.

(d) $1,290,000 of this amount having been distributed as dividends prior to April 14, 1923, the remainder of such amount, or $760,435.93, was distributed by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share, and having been "accumulated since February 28, 1913", was taxable income to the several recipients thereof to the extent received by each.

(e) This sum of $760,435.93 was 14.91% of the total distribution of $5,100,000 ($340 per share) made April 14, 1923, by West Side Lumber Company, and therefore such distribution of $340 per share was 14.91%, or $50.694 per share, taxable to the several recipients within the meaning of section 201 of the Internal Revenue Act of 1921.

(f) The "earnings and profits accumulated since February 28, 1913", having been thus distributed, the balance of the distribution made by the dividend of $340 per share on April 14, 1923, was free from tax in the hands of the recipients thereof under the provisions of section 201 of the Internal Revenue Act of 1921.

(g) The taxable portion of the dividend of April 14, 1923, received by the petitioner from West Side Lumber Company was only 14.91% thereof, or approximately $30,416, which is $2,944 less than was actually returned by him in his income tax return for 1923.

(h) There was no deficiency of tax as to 1923 on the part of your petitioner.

17. The facts upon which the petitioner relies are those facts that are set out in extenso in the findings of fact of said Board of Tax Appeals promulgated on October 27, 1931, which are hereby by
34 reference incorporated in and made a part of this petition with as full force and effect as though set forth in haec verba herein. The statements hereinbefore made are also relied upon and are in form a restatement of the findings of fact of the Board of Tax Appeals.

18. Briefly, the nature of this controversy is the question as to the meaning of section 201 of the Internal Revenue Act of 1921 and in particular as to whether or not losses sustained in specific years following February 28, 1913, are to be deducted from profits gained in other years of such periods since February 28, 1931, in determining the "earnings and profits accumulated since February 28, 1913."

B

The petitioner hereby assigns the following errors with respect to the decision of said Board of Tax Appeals:

1. That said Board erred in finding that the dividend paid by West Side Lumber Company on April 14, 1923, was 22.75% taxable upon the 600 shares of its capital stock held by the petitioner, under the provisions of section 201 of the Revenue Act of 1921.

2. That said Board erred in not finding that the dividend paid by West Side Lumber Company on April 14, 1923, was only 14.91% taxable upon the 600 shares of its capital stock held by the petitioner, under the provisions of section 201 of the Revenue Act of 1921.

3. That said Board erred in failing to deduct the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

4. That said Board erred in so interpreting section 201 of the Internal Revenue Act of 1921 as to require the exclusion of the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

5. That said Board erred in not finding that the entire surplus of West Side Lumber Company of $4,332,684.78 on March 1, 1913, was distributable by it to its stockholders without tax to such stockholders.

6. That said Board erred in finding that only 77.25% of the
35 dividend paid by West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913.

7. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year of 1923 all of his taxable income for that year.

8. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year 1923, $2,944 more of taxable income than was actually received by him for that year.

9. That said Board erred in not finding that the total earnings and profits of West Side Lumber Company accumulated since February 28, 1913, within the meaning of section 201 of the Internal Revenue Act of 1921 were $2,050,435.93.

10. That said Board erred in not finding that only $760,435.93 of the distribution made by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share was accumulated since February 28, 1913, and taxable as income to the several recipients thereof.

Wherefore, this petition respectfully prays that the said decision and order of the Board of Tax Appeals may be reviewed by the Circuit Court of Appeals for the Seventh Circuit as by statute provided, and that the said decision and order of the Board of Tax Appeals be reversed with a finding that there is no deficiency in the tax of the petitioner for the year 1923.

CHARLES J. CANFIELD,
By EDWIN H. CASSELS,
BARRY GILBERT,
His Attorneys.

[*Duly sworn to by Charles J. Canfield, jurat omitted in printing.*]

36 Before U. S. Board of Tax Appeals

Praecipe for record

Filed Feb. 8, 1932

To the Clerk of the Board of Tax Appeals:

You will please prepare the record in the above-entitled proceeding, which is an appeal from a decision of the Board of Tax Appeals promulgated October 27, 1931, in the proceeding entitled "Charles J. Canfield, petitioner, vs. Commissioner of Internal Revenue, respondent, docket 34131", and transmit and deliver to the clerk of the United States Circuit Court of Appeals for the Seventh Circuit, sitting at Chicago, Illinois, duly certified copies of the following documents:

1. All docket entries of proceedings before the Board of Tax Appeals in said proceeding.
2. Pleadings therein before the Board of Tax Appeals.
3. Findings of fact, opinion and decision therein of the Board of Tax Appeals.
4. Petition for review of said decision.
5. The stipulation of facts entered into by the petitioner and the respondent in said proceeding.

Respectfully,

EDWIN H. CASSELS,
BARRY GILBERT,
Attorneys for Charles J. Canfield.

37 [Clerks' certificates to transcript omitted in printing.]

38 [Caption omitted.]
[Appearances of counsel omitted in printing.]

39 IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4761

CHARLES J. CANFIELD, PETITIONER

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Stipulation as to entry of order

Filed June 15, 1932

It is hereby stipulated and agreed by and between the parties hereto that the following order may, with the approval of the Circuit Court of Appeals, be entered in the foregoing cause:

40 "It is ordered and decreed (1) that the report of the Board of Tax Appeals promulgated October 27, 1931, including findings of fact, opinion, and dissenting opinion and concurrence with such dissent, therein contained, is hereby made a part of the record in this cause, and the clerk of this court is hereby directed to print the same in the Transcript of Record; (2) the clerk of this court be directed to print in said transcript the following statement:

"'The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board', and (3) the clerk is hereby directed to omit from the transcript the 'additional praecipe' filed on April 30, 1932, in the Board of Tax Appeals."

EDWIN H. CASSELS and BARRY GILBERT,
Solicitors for Petitioner.
C. M. CHAREST, *Solicitor for Respondent.*

[File endorsement omitted.]

41 IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted.]

Order readdition to record

June 15, 1932

It is ordered and decreed (1) that the report of the Board of Tax Appeals promulgated October 27, 1931, including findings of fact, opinion and dissenting opinion and concurrence with such dissent, therein contained, is hereby made a part of the record in this cause, and the clerk of this court is hereby directed to print the same in the Transcript of Record; (2) the clerk of this court be directed to print in said transcript the following statement:

"'The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board', and (3) the clerk is hereby directed to omit from the transcript the 'additional praecipe' filed on April 30, 1932 in the Board of Tax Appeals."

42 [Appearances of counsel omitted in printing.]

43 IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted.]

Order setting cause

October 4, 1932

It is ordered by the court that this cause be, and the same is hereby, set down for hearing on November 9, 1932.

44 [Minute entry of argument and submission, November 9, 1932, omitted in printing.]

45 IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4761. October term, 1932, January session, 1933

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review of decision of the United States Board of Tax Appeals

Opinion

Filed January 13, 1933

Before ALSCHULER, EVANS, and SPARKS, Circuit Judges.

By this proceeding petitioner seeks to review a decision of the United States Board of Tax Appeals wherein he is charged with a deficiency as to his income taxes for the year 1923 in the sum of $9,243.66. Petitioner denies any deficiency, and claims that he reported in his original return, and paid tax upon, more taxable income than he had received in that year.

The controversy arises out of the declaration of a dividend, on April 14, 1923, by West Side Lumber Company, hereinafter referred to as the company, in the aggregate sum of $5,100,000. The specific question for determination is, What part of that dividend is chargeable to the earnings and profits of the company accumulated since March 1, 1913, and what part is chargeable to the surplus of the company which existed immediately prior to March 1, 1913? Under the law herein involved that part of the dividend properly chargeable to the earnings covered by the period first referred to are taxable, and the remaining portion of the dividend is not taxable.

The facts out of which the controversy arises were stipulated and are as follows:

46 Petitioner resides and has his principal office in Chicago, Illinois. West Side Lumber Company is a California corporation. From March 1, 1913, to April 14, 1923, inclusive, its capital stock consisted of 15,000 shares having a par value of $100, of which petitioner owned 600 shares. On March 1, 1913, the company had a surplus of $4,332,684.78. On April 14, 1923, its surplus had been increased by earnings and profits in the sum of $760,435.93, and at that time its consolidated surplus was $5,109,443.75, which included earnings of a subsidiary company in the sum of $16,323.04.

The earnings and losses of the company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	646,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54 total for year ended Feb. 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

leaving a net profit for those years of $2,050,435.93.

The following dividends were paid by the company after March 1, 1913:

Year ended February 28, 1918	$90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00
September 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,299,000.00

On April 14, 1923, the company declared a dividend of $5,100,000, or $340 for each share of its stock, of which amount petitioner received $204,000.

47 On March 14, 1924, petitioner filed his income-tax return for the calendar year 1923 and reported a net taxable income of $140,656.86. Included in his gross income of that return was an item of $6,000 as taxable income from the dividend received by him on February 12, 1923, as shown above; and likewise included was another item in the amount of $33,360 returned as dividend received on April 14, 1923.

Upon the facts stated the Commissioner concluded that 22.75 percent of the dividend declared on April 14, 1923, to wit, $1,160,688.30, is taxable. The Commissioner arrived at this conclusion by deducting the total dividends declared from February 28, 1918, to February 12, 1923, inclusive, aggregating $1,290,000, from the total

earnings and profits from and including the year 1917 to and including April 14, 1923, aggregating $2,450,688.30. The result of that subtraction is $1,160,688.30, and the Commissioner contends that it truly reflects the accumulated earnings and profits of the company since March 1, 1913. He adds the profits for the year 1914, which amount to $4,594.62, to the surplus of March 1, 1913, and deducts therefrom the losses for 1914 and 1915, which aggregate $404,846.99, thereby reducing the surplus of March 1, 1913, to $3,932,432.41.

The Board of Tax Appeals sustained the findings of the Commissioner, and petitioner challenges the Board's action in that respect.

SPARKS, Circuit Judge: The determination of the question presented calls for the construction of section 201 (a) and (b) of the Revenue Act of 1921, c. 136, 42 Stat. 227. So far as applicable they read as follows:

"(a) That the term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

"(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

48 When the dividend of $5,100,000 was declared by the company on April 14, 1923, it included all the company's accumulated profits and earnings since March 1, 1913, and also most, if not all, of its surplus which existed on March 1, 1913. The statute referred to does not prevent the declaration of a dividend out of that surplus provided there are no undivided profits or earnings left which were accumulate since March 1, 1913. Those undivided profits and earnings must be consumed first, and every distribution of them by way of dividend must be from those most recently accumulated. Up to this point the parties are not at variance, but they differ as to the proper method of determining the amount of earnings and profits accumulated since February 28, 1913.

It is contended by petitioner that the company's accumulated earnings and profits from March 1, 1913, to April 14, 1923, can be ascertained only by deducting the losses for 1914 and 1915, which amount to $404,846.99, from the total earnings and profits of the other years of that period, which aggregate $2,455,282.92. In other words, he contends that the accumulated earnings and profits of the company, within the meaning of the statute as applied to the company, is the difference between the surplus on March 1, 1913, and the surplus on April 14, 1923.

With petitioner's contention we are in accord, and we are convinced that this view is consonant with the intention of Congress as expressed in the language of the statute above referred to.

By reason of the fact that section 201 (b), supra, provides that dividends are presumed to have been made from the most recently accumulated earnings or profits, respondent argues that losses sustained after March 1, 1913, reduce previously accumulated earnings, and may not be treated as suspended to absorb the accumulated earnings of subsequent years. With this contention we cannot agree. If we were here concerned in determining earned surplus for invested capital purposes at a designated date, or if the company were a party to this proceeding and was seeking credit for losses accruing in 1914 and 1915 as against profits in subsequent years respondent's argument might be both pertinent and plausible; but we are required to determine the company's accumulated surplus since March 1, 1913, unaffected, as we see it, by its surplus which existed on that date. In order to arrive at the result as contemplated by the plain words of the statute we think the losses sustained since March 1, 1913,
49 should be deducted from the earnings and profits since that date.

No case has been called to our attention in which the facts are in all respects similar to the facts herein presented. In Hadden v. Commissioner, 49 F. (2d) 709, the court was called upon to determine, under the same statute which we are now considering, the proper method of arriving at the correct amount of profits of a corporation which had accumulated since March 1, 1913. There was no accumulated surplus on that date, but, on the other hand, there was quite a large deficit, which grew each year until in September 1917, when the corporation made a very large profit upon the sale of some of its coal land. The court said:

"No earned surplus can be accumulated until the deficit or impairment of paid-in capital has been made good. Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part. Operating losses sustained after March 1, 1913, must be deducted from profits realized after that date before they can be a taxable profit on the sale of the land, and the accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *."

We are in accord with the rule thus announced, and we think it makes no difference whether or not there be a surplus existing on March 1, 1913. Such construction we do not regard as in any way violating that part of the statute which provides that dividends shall be paid out of the most recently accumulated earnings.

It may or may not be true in the instant case that the losses of 1914 and 1915 were actually paid out of the March 1, 1913, surplus. If

they were thus paid, it can make no difference, because the surplus which then existed, for the purposes of the act, must be considered as capital, and if impaired may be replaced before any tax computation. Southern Pacific Co. v. Lowe, 247 U.S. 330; Lucas v. Alexander, 279 U.S. 573; Old Colony R. Co. v. Commissioner, 284 U.S. 552.

We do not regard the last cited cases as holding that surplus earnings as of March 1, 1913, must in every respect be treated as
50 other capital, or that it is actually capital in the sense that it must be replaced if impaired. But for the purposes of the act it may be replaced if the corporation so desires, and it may deduct that amount from subsequent earnings; and it may, on the other hand, distribute that surplus as dividends without replacement, provided there are no remaining profits or earnings left undisturbed which were accumulated since March 1, 1913.

Under the facts presented there was no deficiency in petitioner's income tax for 1923, and he is entitled to a refund of taxes paid by him for that year, computed on the basis that the distribution of April 14, 1923, was only 14.91 per cent taxable.

The order of the Board is reversed, and the cause remanded for further proceedings not inconsistent with this opinion.

51 In United States Circuit Court of Appeals

4761

CHARLES J. CANFIELD

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

Judgment

Jan. 13, 1933

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on December 21, 1931, by the United States Board of Tax Appeals be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the said United States Board of Tax Appeals for further proceedings not inconsistent with the opinion of this court.

Recital as to issuance of mandate

And afterwards, to wit: On the third day of February 1933 the mandate of this court issued to the United States Board of Tax Appeals.

52 In United States Circuit Court of Appeals for the Seventh Circuit

[Title omitted.]

Motion to recall and stay mandate

Filed Feb. 28, 1933

And now comes the Commissioner of Internal Revenue, respondent in the above-entitled cause, by John P. Barnes, special attorney, Bureau of Internal Revenue, his attorney, and moves the court for entry of an order recalling its mandate, and as grounds for this motion states that the filing with the Supreme Court of the United States of a petition for a writ of certiorari is being considered by the Solicitor General of the United States, and that such petition will probably be filed.

JOHN P. BARNES,
Special Attorney, Bureau of Internal Revenue,
Attorney for Respondent.

[File endorsement omitted.]

53 In United States Circuit Court of Appeals

[Title omitted.]

Order recalling and staying mandate

Feb. 28, 1933

Now this day comes counsel for respondent and presents a motion for recalling and staying the mandate of this court, pending a petition to the Supreme Court of the United States for a writ of certiorari.

On consideration whereof: It is now here ordered that the mandate in this cause be, and the same is hereby, recalled and stayed until the further order of this court.

It is further ordered that counsel for respondent proceed with diligence and promptly file the petition for a writ of certiorari in the Supreme Court of the United States and, upon the filing of said petition file in this court proof of the filing of said petition in said court.

54 [Clerk's certificate to foregoing transcript omitted in printing.]

58 In Supreme Court of the United States

Order extending time within which to apply for writ of certiorari

Filed April 11, 1933

On consideration of the motion of counsel for the petitioner in the above-entitled cause, and good cause therefor having been shown, it is now here ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same hereby is, extended for a period of sixty days from this date.

Dated this eleventh day of April 1933.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

[File endorsement omitted.]

59 SUPREME COURT OF THE UNITED STATES

Order allowing certiorari

Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

60 (Endorsement on cover:) File No. 37,761. U.S. Circuit Court of Appeals, Seventh Circuit. Term No. 158. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Charles J. Canfield. Petition for a writ of certiorari and exhibit thereto. Filed June 10, 1933. File No. 158 O.T. 1933.

U.S. GOVERNMENT PRINTING OFFICE: 1933